

Metropolitan King County Council

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MANAGEMENT LETTER

DATE: September 23, 2003

TO: Metropolitan King County Councilmembers

FROM: Cheryle A. Broom, County Auditor

SUBJECT: Facilities Management Fund Follow-up Review

This letter presents the results of our follow-up review of the financial-related audit of the Facilities Management Fund (Report No. 2002-03). The purpose of the follow-up was to determine the progress the Facilities Management Division has made in implementing audit recommendations for increasing accountability and visibility of costs to tenant agencies, revising its rate-setting models, and complying with accounting standards for internal service funds and with state law.

In our follow-up, we concluded that most of the audit recommendations have been implemented. The models have been revised, more information is provided to agencies on what they are paying for, and parking revenues are now accounted for in accordance with accounting standards and state law. One recommendation that has not been implemented is adjusting rates based on actual expenditures, although the division did factor utility overcharges from 2002 into its 2003 rates.

BACKGROUND

The Facilities Management Fund is the internal service fund for the Facilities Management Division (FMD). Internal service funds are used to account for goods or services provided by one governmental agency to another. Generally accepted accounting principles require that accounting for internal service funds be on a cost-recovery basis, without profit or loss over time.

Revenues to the fund are primarily from the rates that FMD charges for the landlord services it provides to tenants of county buildings. Among these are the square foot rates for building operations and maintenance (rent), and the hourly rates for minor renovation work.

The audit of the Facilities Management Fund in 2002 found that the fund did not meet its stated goals of enhanced accountability and visibility of costs, and that improvements in the rate models would enhance the division's ability to recover expenditures and distribute costs more equitably. The audit also concluded that accounting for the fund was inconsistent with the cost-recovery requirements for internal service funds.

For this follow-up, we reviewed the 2003 square foot rate model and the hourly rate model for minor renovation work. We also conducted a limited review of the fund's financial plan. We interviewed personnel from FMD, the Office of Management and Budget, and the Division of

Finance and Business Operations. We would like to express our appreciation to them and to FMD management for their cooperation.

CONCLUSIONS AND RECOMMENDATIONS

- FMD has improved accountability by increasing the amount of information provided to user agencies.

The division has increased the amount of information it provides on what agencies are paying for. As part of its rate-setting process this year, FMD sent tenant agencies a spreadsheet showing the square foot rates for all county buildings and the components of those rates. In addition, the revised square foot model categorizes and allocates costs more appropriately (see next bullet) to give a more accurate picture of the costs that make up the square foot rates. Invoices for minor renovation work now show the number of hours and type of labor (e.g., carpenter, plumber) billed and include a copy of the invoice of materials used in the job.

We noted in a separate review by this office that the Division of Information and Telecommunications Services publishes its rates and general rate-setting methodology on the county intranet. FMD may want to consider using the intranet to post its rate information as well.

- The rate models have been revised to allocate costs more equitably, operate more on a cost-recovery basis, and correct flaws in the previous methodologies.

Since the audit, the square foot rate model has been revised and the hourly rate models have been completely revamped. The revisions to the models corrected computing errors and flaws in methodology that we noted in our audit and made them operate more on a cost-recovery basis. Significant changes that affect both models include: 1) using revenues from sources other than the rates to offset expenditures and reduce rates; and 2) allocating division management and administrative costs more equitably among the functions in FMD.

For the 2003 hourly rate models, FMD developed a new methodology for calculating the burden rate. This is a factor added to the hourly rate to recover administrative and overhead costs that are not directly billable. The previous models used a "plug number" that would generate the revenue needed, rather than calculating a burden factor based on administrative and overhead costs. The new methodology is based on projected expenditures for those costs. We recommend that FMD management analyze projected revenues against actuals at the end of 2003 to refine the models and improve their accuracy.

The 2003 square foot rate model revised the allocation of security staff costs to reflect staff assignments. The model was also revised to allocate the costs of "free space" more equitably, but could still be improved. Free space is vacant space or space that is occupied by FMD, since FMD does not pay for its space. Our audit found that the 2002 model penalized occupants of buildings where FMD was a tenant by charging them a higher square foot rate. (These buildings are the Courthouse, the Administration Building, and Yesler.) The 2003 model was revised to spread many of the costs of free space among all buildings, but the major expenses, such as custodial staff and utility costs, are still assumed by the tenants of the buildings with vacant or FMD space. Division management said that they will review the methodology and revise as necessary to ensure that occupants of those buildings are not penalized. We recommend that FMD report to the council by September 2004 on any changes in how the costs of free space have been allocated.

The audit also recommended that the rate models be reviewed by a third party. The new models are supposed to be reviewed this year by staff from the Office of Management and Budget and from the Division of Finance and Business Operations. This will include a general review of the assumptions used in the models and the reasonableness of the methodologies, as well as checks of specific formulas for accuracy.

- Accounting for county parking lots was moved from the Facilities Management Fund to comply with generally accepted accounting principles and state law.

The audit found that the accounting practices for the county's parking lots did not comply with accounting standards for internal service funds because the parking rates were set at market value rather than at cost. In addition, the allocation of some of the parking revenues to the Children and Family Set-Aside Fund, a current expense (CX) subfund, was inconsistent with state law that prohibits one fund from benefiting another. Legislation passed this year transferred accounting for the parking lots to CX and provided for CX to reimburse the Facilities Management Fund for the costs of operating and maintaining the lots. The Prosecuting Attorney's Office reviewed the legislation and determined that it would resolve the legal and accounting issues related to the parking lots.

- The Facilities Management Division is not adjusting rates based on actual results.

The rates that FMD charges through the square foot and hourly rate models are set to recover projected expenditures for the coming year. Because internal service funds are supposed to operate without profit or loss over time, the rates should be adjusted based on the difference between budgeted and actual expenditures. However, FMD does not adjust its rates to reflect actual expenditures. FMD did rebate \$1 million through the 2003 square foot rate model to compensate for utility overcharges in 2002.¹ While the methodology was intended to approximate where utility overcharges occurred, adjusting the rates based on actual expenditures is the only way to ensure that rates accurately reflect the costs of services provided, that agencies are not over- or under-charged for any service, and that one rate model or service is not subsidizing another.

If FMD is to adjust rates based on actuals it will be necessary to include in the rates a factor for building or maintaining a target fund balance, and to set what that target should be. County policy offers general guidance on setting a target fund balance for non-CX funds: It should be adequate to support operating expenses, provide for emergency or unanticipated expenditures, provide rate stability, and meet the specific purpose and characteristics of the fund.² However, this policy has been applied differently by the executive and legislative branches. We recommend that the executive submit for council approval a fund balance policy for the Facilities Management Fund, setting a target fund balance and the basis for the target. FMD should use the policy in setting a rate factor that will meet the target. (See the next bullet for further discussion of rate adjustments.)

- FMD will implement a new system to track labor and building costs that should improve the accuracy of the rate models.

FMD will implement a maintenance management system in 2004 that will be used in setting 2005 rates. According to division management, the system will track and report on all labor hours and where they are utilized. By providing more accurate information on the number of hours billed and the amount of non-billable time, it will improve the accuracy of hourly rates.

¹ The Metropolitan King County Council mandated an additional rebate of \$1.4 million for 2003.

² Per Motion 5888, adopted in 1984.

The system should also increase the accuracy of square foot charges because most costs will be tied directly to the building where they are actually expended. Administrative costs will then be the only costs to be allocated rather than directly charged to the benefiting agency.

According to FMD management, implementation of the maintenance management system will also enable them to link projected expenditures with actuals. With the recent revisions, the current models have become so complex that adjusting the rates based on actual expenditures could be difficult. FMD management believes that the new system should simplify the rate models considerably and, coupled with an adopted policy on the internal service fund balance, will allow them to make rate adjustments based on actual results.

We recommend that beginning with the 2005 rates, FMD compare actual expenditures against budgeted, adjust its rates accordingly, and use that information to refine the models' accuracy. We also recommend that FMD report to the council by September 2004, on the new maintenance management system's impact on the rate-setting methodology. Finally, because the 2005 rate models should be substantially different from the current models, we recommend that FMD have them reviewed for accuracy and reasonableness by the Division of Finance and Business Operations and the Office of Management and Budget.

Nancy McDaniel and Bert Golla conducted this management review. Please contact them or me if you have any questions about the issues discussed in this letter.

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